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No. 87-984

In the Supreme Court of the United States

OCTOBER TERM, 1987

SHELL OIL COMPANY, APPELLANT

v.

IOWA DEPARTMENT OF REVENUE

ON APPEAL FROM THE SUPREME COURT OF IOWA

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether, for purposes of determining the amount of income of a multi-state corporation that may be apportioned to any one of the States in which it does business, the Outer Continenal Shelf Lands Act, 43 U.S.C. 1333(a), which provides, inter alia, that "State taxation laws shall not apply to the outer Continental Shelf," precludes the inclusion of income earned from the sale of oil and gas extracted from the Outer Continental Shelf in the pre-apportioned income base of the State's apportionment formula.

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INTEREST OF THE UNITED STATES

In response to this Court's invitation, the United States recently filed a brief as amicus curiae in *Shell Oil Co.* v. *Department of Revenue, State of Florida*, appeal pending, No. 86-1593, which raises the related question whether the Outer Continental Shelf Lands Act, 43 U.S.C. 1332(a)(2)(A), limits a State's authority to tax an apportioned fraction of income earned from the sale within the United States of oil extracted from the Outer Continental Shelf. This brief is submittted because certain statements made in appellant's jurisdictional statement in this case appear to misapprehend the views expressed by the United States in its brief in No. 86-1593, and because that brief contained a comment about the present case that was based on a factual misimpression by us concerning Iowa tax law.

STATEMENT

1. Appellant Shell Oil Company (Shell) is a Delaware corporation engaged in the unitary business of exploring for, refining and marketing oil and gas products (J.S. App. 7a, 16a-17a). Shell conducts its production activities within various States and on the Outer Continental Shelf (OCS) (*id.* at 20a, 48a). Shell sells all natural gas produced on the OCS at the platform on OCS lands (*id.* at 7a-8a). In

contrast, most of Shell's crude oil is transferred off OCS lands to pipelines for transport to the continental United States, where it is delivered to refineries or other manufacturing facilities (*id.* at 8a, 20a, 25a). Shell's principal business in Iowa during the years at issue consisted of marketing oil and chemical products that had been refined and manufactured outside Iowa (*id.* at 8a, 17a-18a).

The State of Iowa imposes an income tax, administered by appellee Iowa Department of Revenue (Iowa), on the apportioned share of "net income" that is "reasonably attributable to the trade or business within the state" (J.S. App. 8a, 95a-96a; see Iowa Code Ann. § 422.33(1), (2) and (2)(b)(4) (West Supp. 1987)). Under Iowa law, a corporation's "net income" is its taxable income for federal income tax purposes, as adjusted pursuant to Section 422.35 of the Iowa Code (J.S. App. 96a; see Iowa Code Ann. § 422.35 (West Supp. 1987)). The amount of total net income attributed to business conducted in Iowa is determined under a one-factor formula, which is based on the ratio of sales made in Iowa to gross sales everywhere (see Iowa Code Ann. § 422.33(2)(b)(4) (West Supp. 1987); J.S. App. 27a):

$$\frac{\text{Iowa Gross Sales}}{\text{Everywhere Gross Sales}} \times \text{Federal Taxable Income Adjusted Per Iowa Law} = \text{Iowa Income}$$

In computing the portion of its net income attributable to business done within Iowa for the years 1978 through 1980, Shell excluded from the net income subject to apportionment the amount it determined to represent actual or deemed earnings from OCS oil and gas production (J.S. 8; J.S. App. 27a). For oil and gas sold to third parties on the OCS, Shell excluded its gross receipts from those sales, less related costs and expenses. Where the oil was simply transferred to pipelines for transportation to shore, the

amount excluded consisted of the wellhead fair market value of the oil, less related costs and expenses (J.S. App. 21a, 27a; J.S. 2 n.1, 8 n.4). The result was the following adjustment of Iowa's one-factor formula:

$$\frac{\text{Iowa Gross Sales less OCS Gross "Sales" actually made and wellhead fair market value of oil transported to shore}}{\text{Total Gross Sales less OCS Gross "Sales" actually made and wellhead fair market value of oil transported to shore}} \times \text{Non OCS Taxable Income} = \text{Iowa Income}$$

The Iowa Department of Revenue rejected this modification to Iowa's apportionment formula, and issued a notice of assessment computing Shell's Iowa income in accordance with the apportionment formula established by Iowa law (J.S. App. 70a).

2. Shell contested the increase in tax in a hearing before the Iowa Department of Revenue. Shell contended that under the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. 1333(a)(2)(A), it was entitled to exclude OCS revenues from its pre-apportionment net income base. The hearing officer rejected Shell's contention on the ground that the inclusion in the apportionment formula of income Shell attributed to its OCS activities, did not itself entail an application of Iowa's tax law to the OCS in contravention of OCSLA (J.S. App. 72a-74a, 37a).

3. The Iowa District Court for Polk County affirmed the final order of the hearing officer (J.S. App. 15a-35a). The district court concluded (*id.* at 32a-33a) that "Iowa's apportionment scheme does not tax income derived by Shell solely from the OCS. Rather, Iowa's indirect taxation of Shell's OCS income is directly attributable to Shell's sales within the State of Iowa."

4. The Iowa Supreme Court affirmed (J.S. App. 1a-14a). The court concluded (*id.* at 12a-13a) that neither the legislative history nor the language of OCSLA evidences a compelling indication that Congress intended to prohibit the apportionment of income derived from the sales of OCS oil and gas for the purpose of obtaining an accurate measure of the tax to be imposed on in-state business activities.

5. While Shell's appeal was pending before the Iowa Supreme Court, the Florida Supreme Court rendered a decision against Shell in a lawsuit similar to this one, holding that OCSLA does not limit Florida's authority to tax an apportioned share of income from the sale within Florida of oil extracted from the OCS. Shell appealed the decision of the Florida court to this Court. *Shell Oil Co.* v. *Department of Revenue, State of Florida*, appeal pending, No. 86-1593. The United States has submitted a brief as amicus curiae in that appeal in response to the Court's order inviting the Solicitor General to express the views of the United States. In that brief, we argue that OCSLA's provision (43 U.S.C. 1333(a)(2)(A)) that "[s]tate taxation laws shall not apply to the outer Continental Shelf" simply reflects congressional intent that the OCS be treated as an area of exclusive federal jurisdiction outside the borders of any State. We thus indicate that OCSLA precludes a State from taxing activities on the OCS in the same manner that the Constitution precludes a State from taxing activities in another State or in a foreign nation. It does not, we maintain, prohibit a State from taxing income derived in the State from the sale of oil and gas extracted from the OCS.

DISCUSSION

Shell contends in its jurisdictional statement that OCSLA precludes Iowa from including in its tax apportionment formula Shell's gross sales and its total income, unless there are eliminated therefrom sales made on the OCS and any income earned by Shell from the extraction

of OCS oil and gas. It argues that this prohibition applies both to the income it realized on sales of oil and gas completed on the OCS and to the value of OCS oil and gas (less expenses) transported to shore for sale there (J.S. 12). According to Shell, the inclusion of income derived from OCS oil and gas in Iowa's apportionment formula constitutes the application by Iowa of its tax laws to the OCS in contravention of the express language of OCSLA. This claimed violation of OCSLA is not contended to be a consequence of any deficiency in Iowa's statutory apportionment formula; Shell specifically disclaims any challenge to Iowa's apportionment scheme (*ibid.*).

In support of its position, Shell mistakenly attributes to the United States the view that "a decision sustaining *apportionment* of OCS income from sales on the Shelf would be in 'error' " (J.S. 11 (emphasis added)). To be sure, as Shell points out, the United States indicated in its brief as amicus curiae in No. 86-1593 that a State may not *tax* income earned from sales of OCS oil or gas that are completed on the OCS and further stated (at 17 n.12), with respect to the instant case, that "[i]f the Iowa Supreme Court were to uphold state taxation of earnings from OCS sales, that holding would appear to be error * * *."[1] The United States, however, contrary to Shell's claim here, did not express the view that the inclusion in a State's apportionment formula of income derived from OCS sales of oil or gas would constitute taxation by the State of such income in contravention of OCSLA.

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[1] At the time we filed our amicus brief in No. 86-1593, we were under the misimpression that Iowa law, unlike Florida law, purported to *tax* income from sales completed on the OCS itself (at 17 & n.12). The Iowa Supreme Court's subsequent decision in this case establishes, however, that Iowa does not purport to tax such income, but merely includes those sales in its apportionment formula to determine what values should be deemed local and, hence, subject to local tax. See J.S. App. 11a-13a.

Indeed, such a view would be fundamentally at odds with the decisions of this Court upholding, in general, the constitutionality of comparable state apportionment formulae. See, *e.g.*, *Container Corp. of America* v. *Franchise Tax Bd.*, 463 U.S. 159 (1983); *Exxon Corp.* v. *Dep't of Revenue*, 447 U.S. 207 (1980); *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425 (1980); see also *Moorman Mfg.* v. *Bair*, 437 U.S. 267 (1978). These decisions are founded on the principle that inclusion by a State in its apportionment formula of income from sales in other States does not, in itself, entail the taxation by the State of extraterritorial values. The basic function of an apportionment formula is to ascertain what values should be deemed local, and what values should be deemed extraterritorial, and to tax only the former, not the latter (*ibid.*). It follows from this principle that Iowa, in including OCS sales and income in its apportionment formula, has not, *ipso facto*, extended its tax laws to the OCS any more than its inclusion in that formula of sales and of income earned by Shell in another State or in a foreign country would necessarily constitute an application of its tax laws to that State or that country. Of course, it is a distinct question whether the *amount* of income attributed to Iowa by its apportionment formula exceeds the limitations imposed by the Due Process and Commerce Clauses on a state's apportionment of income derived from activities occurring in another jurisdiction (*ibid.*; cf. *Exxon Corp.* v. *Dep't of Revenue*, 447 U.S. at 227 n.11). We do not, however, understand Shell to undertake such a challenge here and, hence, we do not address that issue. See J.S. i, 7 & n.3, 12. But see *id.* at 21 & n.36.

For the reasons stated in our amicus brief in No. 86-1593 (at 5-10), we agree with the Iowa Supreme Court (J.S. App. 13a) that, absent a clear indication to the contrary in the legislative history, OCSLA should not be construed as precluding Iowa from utilizing Shell's OCS income in the measurement of the tax to be imposed on Shell's Iowa activities. And, like the Iowa court, we also

believe that the legislative history contains no such contrary indication (see 86-1593 U.S. Amicus Br. at 11-16). Nonetheless, for the reasons stated in our amicus brief in No. 86-1593, although we therefore believe that the decision of the Iowa Supreme Court is correct, we are unable to conclude that the federal question is completely "insubstantial" and hence think it would be appropriate for the Court to note probable jurisdiction.[2]

Respectfully submitted.

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[2] Should the Court decide to grant plenary review, it may wish to consider doing so only in the present case (while holding No. 86-1593) because this case, unlike No. 86-1593, involves sales both on and off the OCS.

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